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State seeking 'overdraft protection' to stave off budget collapse

ARIZONA - What amounts basically to attaining "overdraft protection," the State of Arizona is working to establish a "line of credit" with banks in order to borrow possibly as much as \$5.7 billion in the next three months in an effort to stave off mandatory placement of the state's General Fund into receivership.

According to Arizona State Treasurer Dean Martin, during a telephonic interview with the Bullhead City Bee in early January, in the six-month period between July and November 2008, the state had spent on average in excess of \$28 million per day and during that same period, collected only about \$22.4 million per day.

Martin said the state is resorting to the 'line-of-credit' strategy "basically to get us through the rest of the year. The easiest way to think about this when the state had plenty of money and was not spending more than it made, it had a nice, healthy bank balance (but), as a result of two years now of spending substantially more than revenues, we took what was more than a \$1.8 billion bank balance down to zero (in the next 60-90 days). And so at this point, basically, the state is living paycheck to paycheck," said the state treasurer.

Martin was asked that, in view of the fact banks are not loaning money to businesses across the nation - despite \$700 billion "bailout" money recently provided to them by the federal government - how can the state expect to establish a line of credit, much less borrow money from banks.

"We've already been talking to Bank of America, the servicing bank for us which processes the state's checks when they go through. Since we're already in a contract with them, we've been talking to them about essentially using this as a line of (overdraft) credit, and based on what we need through 2009 in our current forecast, they think they can handle that themselves because of the money they've already gotten. They've got enough capital," said Martin, pointing out that, "Arizona's a small state."

Martin was asked if Bank of America was experiencing the same problems as other banks, which had relaxed lending standards to accommodate sub-prime loans to non-qualified borrowers. "Not as much, that's correct. I don't think there was a big bank out there that didn't have some exposure to it but they didn't have anywhere near the exposure as others (banks) did," the state treasurer said.

According to a press release issued on Jan. 5 by the treasurer's office, under current projections, the state will be "in the red" as early as Feb. 23, 2009 and will exhaust the "rainy day" fund a month later in March. "At this point, we will have no choice but to call in \$110 million in loans made to fund transportation projects which ADOT (the Arizona Department of Transportation) has informed us will have a severe impact on construction and maintenance projects," Martin was quoted as saying in the press release. "They (ADOT) use \$60 million of this money as their working capital. Without it, I am not sure how many projects could be affected," Martin added.

Attorney General Terry Goddard's office has stated that before the state's General Fund balance falls below zero, the state treasurer's office is "required by law, to liquidate any remaining rainy day funds and call in all loans to ADOT for transportation projects," said Martin, noting that, "even

that won't be enough. At the current rate of spending, we will need \$2.5 to \$5.7 billion in loans just to continue to make payroll."

The treasurer's office has monitored the current severe budget deficit situation for more than a year and has held regular meetings with the Governor's General Accounting Office for the past three months to discuss how the rest of the state will operate when the General Fund is out of money.

ARS 35-185.01 authorizes the State Treasurer to issue Treasurer Warrant Notes (debt) to pay general fund obligations. "According to statute, this puts the State General Fund into receivership. All funds collected each day by the General Fund are placed in the Treasurer's Warrant Note Redemption Fund to pay any outstanding Warrant Notes," said the press release from the treasurer's office. "Then new warrant notes are issued to pay the next days' bills. Statute does not allow me to stop paying or to slow payments," said Martin.

"Debts will automatically continue to climb as long as the state continues to spend. Only a new revised budget passed by the legislature and signed by the governor can reduce spending. Unfortunately, the taxpayers will be stuck with the bill for the interest costs," said Martin. "Should the economic situation worsen, and credit markets tighten to a point where the daily borrowing is not available, the state would begin to default on its loans, which would devastate our credit rating," he explained. "In anticipation of this situation, we have been negotiating with our servicing bank to establish a line of credit to meet the State's needs.

"I will be calling the State Loan Commission later this week in order to set the maximum interest rate." The State Loan Commission consists of the treasurer, governor and director of the Department of Administration.

"Unfortunately next fiscal year will be even worse. The last two years of budget spending in excess of revenues have depleted the State's reserves. Within the first two weeks of the next fiscal year the State will be in the red, and stay there for most of the year. Next year's problem makes this year's look like a drop in the bucket," Martin's press release stated.

"Even if some sort of fiscal stimulus package from the federal government should arrive (without spending strings attached) in time to save the State, it does not solve the fundamental problem; it just kicks the can down the road to next year. The only way to keep the state out of bankruptcy is to bring ongoing spending in line with revenues."

In FY 2008, ongoing spending obligations of the state increased, according to Martin's office, by 10.52 percent while revenues dropped by 8.93 percent. This year, ongoing spending obligations increased by 6.61 percent to a record \$11.1 billion, "while revenues are on a track to drop by (11.5 percent) to (13.6 percent) at barely over \$7.6 billion. The new legislature and governor must address this problem quickly or the State will be looking at bankruptcy next year," said Martin.

State officials are scheduled to meet next Monday and begin addressing issues relating to the budget for fiscal year 2009-10. The new budget starts on July 1, 2009. "The quicker they solve this, the better off the state will be," said Martin, concluding his telephone interview.

By Thom McGraham
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